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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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PLR-113791-10

Date:

September 13, 2010

LEGEND

Distributing =

StateA =

Date1 =

Date2 =

#W =

ShareholderA =

#X =

%X =

ShareholderB =

#Y =

%Y =

Business1 =

Business2 =

Services3 =

ControlledA =

ControlledB =

Dear :

We respond to your March 15, 2010 request for rulings regarding certain federal income tax consequences of a proposed transaction. The information submitted in that request, and in subsequent correspondence, is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the appropriate parties.

This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the proposed transaction: (i) satisfies the business purpose requirement of Treas. Reg. §1.355-2(b); (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation and/or the controlled corporations (see section 355(a)(1)(B) of the Internal Revenue Code (the "Code") and Treas. Reg. §1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporations (see section 355(e) and Treas. Reg. §1.355-7).

Summary of Facts

Distributing is a StateA corporation that uses the accrual method of accounting and a calendar year. Distributing was incorporated on Date1, and elected S corporation status effective Date2.

Distributing has outstanding #W shares of voting common stock (and no other stock). ShareholderA owns #X shares of Distributing's common stock (%X) and ShareholderB owns the remaining #Y shares of Distributing's common stock (%Y). ShareholderB is the President of Distributing while ShareholderA is the Vice-President and Secretary.

Distributing is engaged in Business1 and Business2, and provides Services3.

Distributing has proposed the following transaction (the Proposed Transaction) in order to resolve shareholder/management disputes as well as to isolate potential liabilities associated with Business2.

Proposed Transaction

1. ControlledA and ControlledB will be formed as StateA corporations;
2. Distributing will transfer the Business1 assets and other assets to ControlledA and ControlledB in exchange for all of the stock of ControlledA and ControlledB and the assumption by ControlledA and ControlledB of the liabilities associated with those assets (the Contributions). The assets will be transferred proportionally %X to ControlledA and %Y to ControlledB.
3. As of the date of the Contributions (the Contributions Date), Distributing will distribute all of the stock of ControlledA to ShareholderA and all of the stock of ControlledB to ShareholderB (the Distributions).
4. Each of ControlledA and ControlledB will make an election under section 1362(a) to be treated as an S corporation (within the meaning of section 1361(a)), to be effective on the Contributions Date.

Representations

The following representations have been made with respect to the Proposed Transaction:

- a) Distributing, ControlledA, ControlledB, ShareholderA and ShareholderB will each pay their own expenses, if any, incurred in connection with the Proposed Transaction.
- b) No intercorporate debt will exist between or among Distributing, ControlledA and ControlledB at the time of, or subsequent to, the distribution of the stock of ControlledA and ControlledB.
- c) The indebtedness owed by ControlledA or ControlledB to Distributing after the Distributions, if any, will not constitute stock or securities.
- d) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

e) The five years of financial information submitted on behalf of Business1 conducted by Distributing is representative of its present business operations, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.

f) The five years of financial information submitted on behalf of Business2 conducted by Distributing is representative of its present business operations, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.

g) Following the Proposed Transaction, Distributing will continue the active conduct of Business2, and each of ControlledA and ControlledB will continue the active conduct of their respective shares of all the integrated activities of Business1 conducted by Distributing prior to consummation of the Proposed Transaction. Each of Distributing, ControlledA and ControlledB will conduct their respective businesses independently with their separate employees, except that certain employees will be shared on an interim basis. For any employee who is shared by the corporations, any such employee's compensation will be shared by the corporations based upon the amount of time spent in each corporation's business, and each corporation will issue a separate Form W-2 to any such employee.

h) The distributions of the stock of ControlledA and ControlledB will be carried out for the following corporate business purposes: (i) in order to resolve shareholder/managerial disputes that are hindering the operations of Business1; and (ii) risk reduction. The distributions of the stock of ControlledA and ControlledB are motivated, in whole or substantial part, by one or more of these corporate business purposes.

i) The Proposed Transaction is not used principally as a device for the distribution of the earnings and profits of Distributing, ControlledA or ControlledB.

j) The total adjusted basis and the fair market value of the assets to be transferred to ControlledA and ControlledB by Distributing each will equal or exceed the sum of the liabilities to be assumed (within the meaning of section 357(d)) by ControlledA and ControlledB plus any liabilities to which the assets to be transferred are subject.

k) The liabilities to be assumed (within the meaning of section 357(d)) by ControlledA and ControlledB in the Contributions, if any, and the liabilities to which the transferred assets are subject, if any, were incurred in the ordinary course of business and are associated with the assets being transferred.

l) The fair market value of the assets of ControlledA and ControlledB will exceed the amount of the liabilities of ControlledA and ControlledB, respectively, immediately after the exchange.

m) No investment credit determined under section 46 has been (or will be) claimed with respect to any of the property to be transferred from Distributing to ControlledA and ControlledB.

n) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.

o) Payments made in connection with all continuing transactions, if any, between Distributing, ControlledA and ControlledB, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

p) No parties to the Proposed Transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).

q) For purposes of section 355(d), immediately after the Distributions, no person (determined after applying section 355(d)(7)) will hold stock possessing 50-percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50-percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distributions.

r) For purposes of section 355(d), immediately after the Distributions, no person (determined after applying section 355(d)(7)) will hold stock possessing 50-percent or more of the total combined voting power of all classes of ControlledA stock entitled to vote, or 50-percent or more of the total value of shares of all classes of ControlledA stock, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distributions or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distributions.

s) For purposes of section 355(d), immediately after the Distributions, no person (determined after applying section 355(d)(7)) will hold stock possessing 50-percent or more of the total combined voting power of all classes of ControlledB stock entitled to vote, or 50-percent or more of the total value of shares of all classes of ControlledB stock, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distributions or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distributions.

t) The Distributions are not part of a plan or series of related transactions (within the meaning of §1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of section 355(d)(4)) in Distributing, ControlledA, or ControlledB (including any predecessor or successor of any such corporation).

u) Immediately after the Distributions, neither Distributing, ControlledA, nor ControlledB will be a disqualified investment corporation (within the meaning of section 355(g)(2)).

v) Effective Date 2, Distributing made an election under section 1362(a) to be an S corporation (within the meaning of section 1361(a)), and Distributing continued to be an S corporation since Date 2.

w) Immediately after the Distributions, ControlledA and ControlledB will each be eligible to elect S corporation status pursuant to section 1362(a), effective immediately after the Distributions.

x) ControlledA and ControlledB will each elect to be an S corporation pursuant to section 1362(a) on the first available date after their formation, and there is no plan or intent to revoke or otherwise terminate the S corporation election of Distributing, ControlledA or ControlledB.

Rulings

Based solely on the information submitted and the representations made, we rule as follows:

1) The transfer by Distributing to ControlledA of part of its assets in exchange for all of the ControlledA stock and assumption of liabilities followed by the distribution of all the ControlledA stock to ShareholderA will constitute a reorganization within the meaning of section 368(a)(1)(D). Distributing and ControlledA each will be "a party to a reorganization" within the meaning of section 368(b).

2) The transfer by Distributing to ControlledB of part of its assets in exchange for all of the ControlledB stock and assumption of liabilities followed by the distribution of all the ControlledB stock to ShareholderB will constitute a reorganization within the meaning of section 368(a)(1)(D). Distributing and ControlledB each will be "a party to a reorganization" within the meaning of section 368(b).

3) No gain or loss will be recognized by Distributing on the Contributions. Sections 357(a) and 361(a).

- 4) No gain or loss will be recognized by ControlledA and ControlledB on the Contributions. Section 1032(a).
- 5) ControlledA's basis in each asset received from Distributing in the Contributions and ControlledB's basis in each asset received from Distributing in the Contributions will equal the basis of such asset in the hands of Distributing immediately before its transfer. Section 362(b).
- 6) The holding period for each asset received by ControlledA and ControlledB from Distributing in the Contributions will include the period during which such asset was held by Distributing. Section 1223(2).
- 7) No gain or loss will be recognized by Distributing on the Distributions. Section 361(c)(1).
- 8) No gain or loss will be recognized by (and no amount will be included in the income of) ShareholderA and ShareholderB upon the receipt of ControlledA stock and ControlledB stock, respectively, in the Distributions. Section 355(a)(1).
- 9) The aggregate basis of the Distributing stock and the ControlledA stock in the hands of ShareholderA will be the same as the aggregate basis of the Distributing stock held by ShareholderA immediately before the Distributions, allocated between the Distributing stock and the ControlledA stock in proportion to the fair market value of each in accordance with Treas. Reg. §1.358-2(a). Section 358(a), (b), and (c).
- 10) The aggregate basis of the Distributing stock and the ControlledB stock in the hands of ShareholderB will be the same as the aggregate basis of the Distributing stock held by ShareholderB immediately before the Distributions, allocated between the Distributing stock and the ControlledB stock in proportion to the fair market value of each in accordance with Treas. Reg. §1.358-2(a). Section 358(a), (b), and (c).
- 11) ShareholderA's holding period of the ControlledA stock and ShareholderB's holding period of the ControlledB stock received in the Distributions will include the holding period of the Distributing stock with respect to which the Distributions will be made, provided that the Distributing stock is held as a capital asset on the date of the Distributions. Section 1223(1).
- 12) Distributing's earnings and profits will be allocated between Distributing and ControlledA and between Distributing and ControlledB in accordance with section 312(h) and Treas. Reg. §1.312-10(a).
- 13) The accumulated adjustments account of Distributing will be allocated between Distributing and ControlledA and Distributing and ControlledB in a manner similar to the

manner in which the earnings and profits of Distributing will be allocated under section 312(h) in accordance with Treas. Reg. §1.1368-2(d)(3).

14) Provided that the Distributions are undertaken immediately after the Contributions, Distributing's momentary ownership of the stock in ControlledA and ControlledB, as part of the reorganization under section 368(a)(1)(D), will not cause ControlledA and ControlledB to have an ineligible shareholder for any portion of their respective first taxable year under section 1361(b)(1)(B) and will not, in itself, render ControlledA and ControlledB ineligible to elect to be an S corporation for their respective first taxable year.

15) Neither the stock of ControlledA nor the stock of ControlledB will qualify as section 1244 stock. Section 1244(c)(1)(B).

Caveats

We express no opinion about the tax treatment of the Proposed Transaction under other provisions of the Code and regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that is not specifically covered by the above rulings. In particular, we express no opinion regarding whether the Proposed Transaction: (i) satisfies the business purpose requirement of Treas. Reg. §1.355-2(b); (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation and/or the controlled corporations (see section 355(a)(1)(B) and Treas. Reg. §1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporations (see section 355(e) and Treas. Reg. §1.355-7).

Procedural Statements

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of this letter ruling.

In accordance with a power of attorney on file in this office, a copy of this ruling letter is being sent to your authorized representatives.

Sincerely,

Thomas I. Russell

Thomas I. Russell
Senior Counsel, Branch 5
Office of Associate Chief Counsel (Corporate)

cc: